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POLICY BRIEF

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Highlights



Despite fulfilling required criteria for graduation from the LDC group, Bangladesh suffers from structural 'transformation deficit'.



Slow progress in structural transformation is linked with less growth in 'between sector productivity' and poor performance in export diversification.



The projected 'flat' nature of structural transformation indicates that the transition to graduation would be difficult.



Both labour and sectoral productivity will need to increase significantly through rise in private and foreign direct investment, transfer of technology, and higher managerial skills.



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House - 6/2 (7th & 8th floors)
Block - F, Kazi Nazrul Islam Road
Lalmatia Housing Estate
Dhaka - 1207, Bangladesh
Telephone: (+88 02) 58152779, 9141703,
9141734, 9143326, 9126402
Fax: (+88 02) 48110414
E-mail: info@cpd.org.bd

'Business as Usual' Trend of Structural Transformation: Can this Ensure Graduation with Momentum?

Khondaker Golam Moazzem and Akashlina Arno

Introduction

Bangladesh is expected to be one of the first economies to graduate from the least developed country (LDC) group by fulfilling all three graduation criteria – gross national income (GNI) per capita, the Human Assets Index (HAI) and the Economic Vulnerability Index (EVI). However, the graduation in 2024 would not be an unmixed blessing for Bangladesh, as the economy would experience a number of challenges in the post-graduation phase. Following graduation, Bangladesh would find it difficult to maintain her global competitiveness and thereby to sustain economic growth unless measures are taken for improvement in structural transformation (Drabo and Guillaumont, 2016; Bhattacharya and Khan, 2014). Literature shows that a majority of the LDCs suffer from severe *transformation deficits* – most of them lack adequate capacity for structural transformation despite the fact that they have experienced considerable economic growth. In this connection, it is important to know whether the graduation criteria positively influence a country's structural change. Keane, Aldafai and Arda (2016) found that the majority of the LDCs focusing on the graduation criteria struggle when it comes to accelerating structural transformation. While a few indicators under the graduation criteria could be linked to a positive structural change, it is important to analyse whether these indicators have adequate influence on structural transformation.

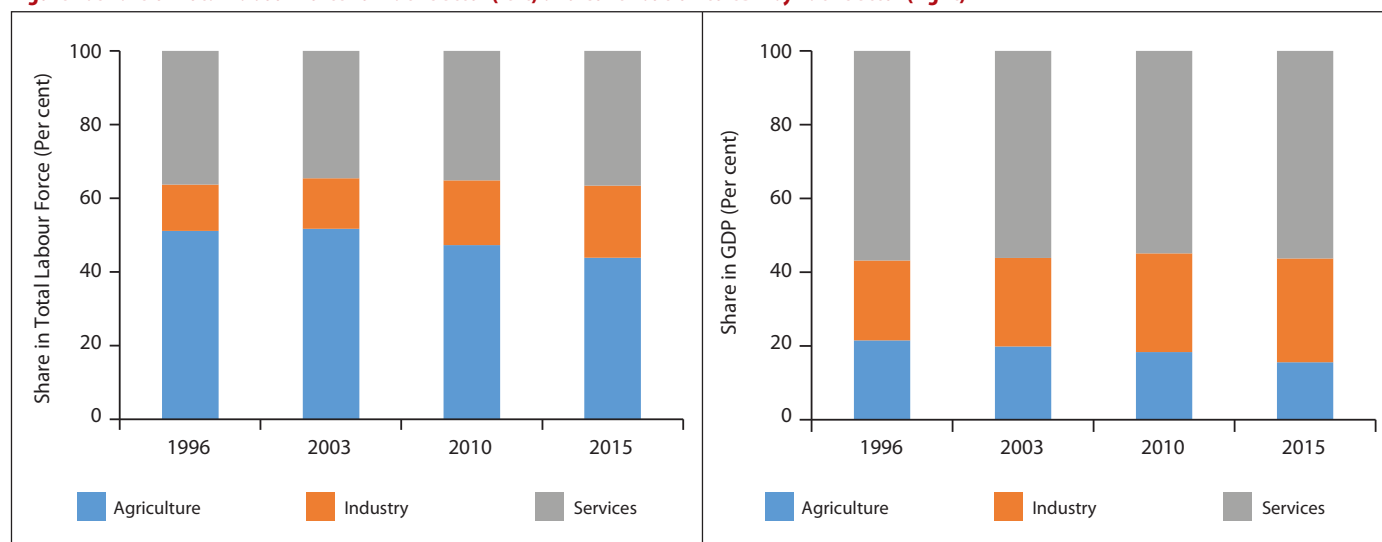
This brief examines the benchmark situation for Bangladesh's structural transformation and provides a better understanding of possible structural changes during the transition period towards graduation. It identifies the required level of structural transformation during the post-graduation phase with a view to ensure smooth transition to graduation. The overall relationship has been examined at two stages: a) graduation-led structural transformation and b) structural transformation-enabled smooth transition after graduation. Given the analysis of the benchmark situation and needed future levels of structural change in Bangladesh, the policy brief outlines appropriate policies and measures to overcome expected challenges.

Benchmark Situation of Bangladesh's Structural Transformation

Over the last several decades, Bangladesh has experienced slow progress in structural transformation. The agriculture sector continues to have the largest share of the total labour force despite its low contribution to gross domestic product (GDP) (Figure 1), which indicates a low level of structural transformation over the years. The share of the total labour force in agriculture decreased from 51.1 per cent in 1995-96 to 43.9 per cent in 2015, with a change in the agriculture sector's contribution to GDP from 21.4 per cent in 1995-96 to 15.5 per cent in 2015. More importantly, there have been limited changes in sectoral productivity and the movement of labour across sectors, which suggests that structural transformation in Bangladesh is almost stagnant.

A disaggregated analysis of productivity reveals that the majority of the growth in labour productivity resulted from 'within sector productivity' rather than 'between sector

Figure 1: Share of Total Labour Force for Each Sector (left) and Contribution to GDP by Each Sector (right)

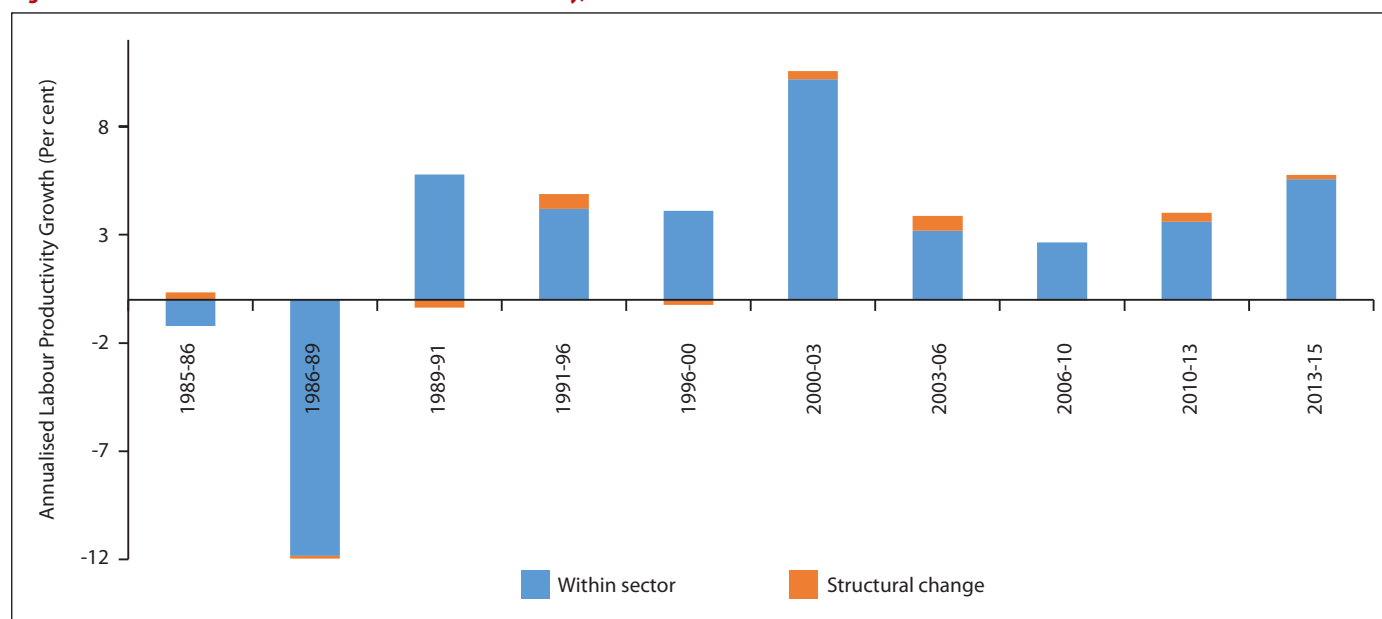


Source: Labour Force Surveys.

productivity' (Figure 2). 'Between sector productivity', which indicates the structural transformation of an economy, actually decreased from 0.3 per cent during 1985-86 to only 0.2 per cent during 2013-15, with the average structural change for the 30 years being 0.2 per cent. Export diversification, which is another indicator for structural transformation, is also found to be weak over the past

in trade openness. All these improved indicators significantly contributed in accelerating external trade, facilitating participation in global value chains and maintaining a stable macroeconomic environment. Despite the positive changes, the economy is expected to struggle, given the present direction of structural change as it approaches graduation in 2024.

Figure 2: Growth of 'within' and 'between' Sector Productivity, 1985-2015



Source: UN database; Labour Force Surveys.

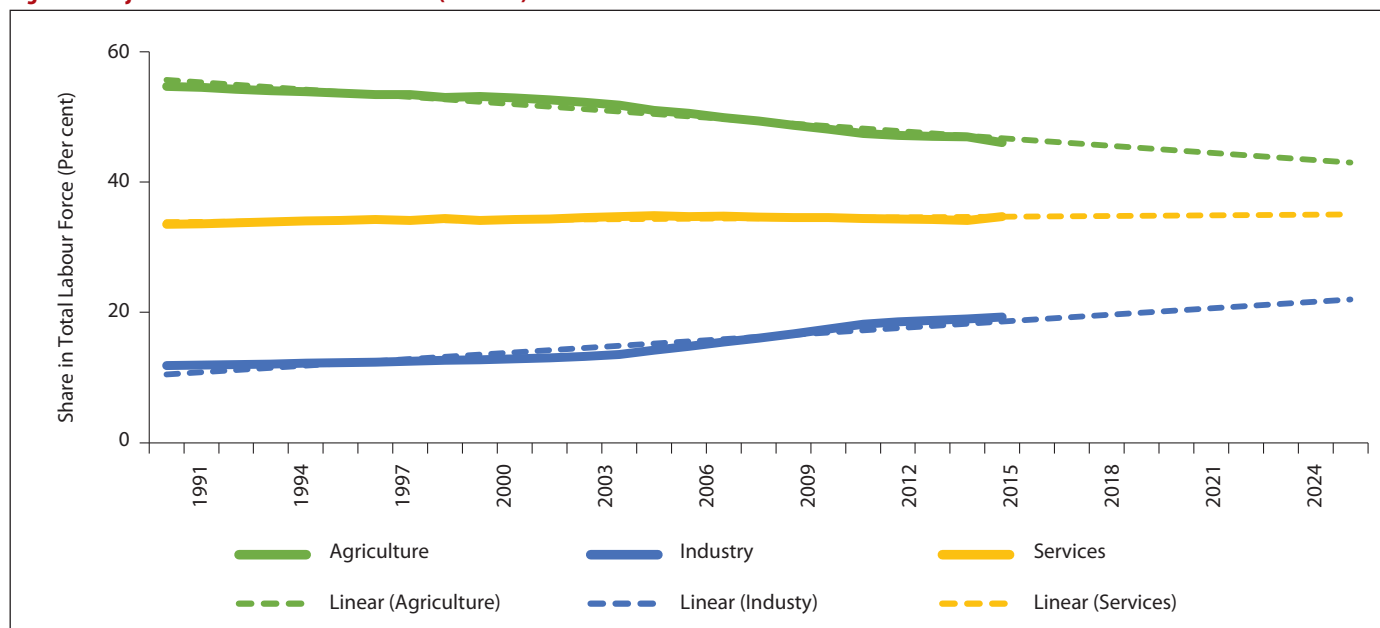
decades. In comparison to selected export-competing countries such as India, Indonesia, Pakistan and Vietnam, Bangladesh performed the worst in export diversification with a steady rise of the value from 0.33 in 1995 to 0.4 in 2015.

In contrast, the majority of macroeconomic indicators are found to be in a favourable condition over the past two decades in terms of, for instance, consistent economic growth with a rise in per capita income, reduced debt service payments (in terms of GDP) against long- and medium-term loans, a less volatile inflation rate and a rise

Graduation-led Structural Transformation

Graduation-led structural transformation indicates Bangladesh's pathway towards successful structural transformation, especially as it nears graduation from the LDC group. Bangladesh's future macroeconomic trends appear to be favourable, as most of the indicators such as GDP growth, inflation, debt sustainability and unemployment seem to be moving in a positive direction. However, Bangladesh's projected macroeconomic performance until 2024 will partly depend on global macroeconomic conditions in the

Figure 3: Projected Movement of Labour Force (till 2024)



Source: Authors' estimates based on International Labour Organization data.

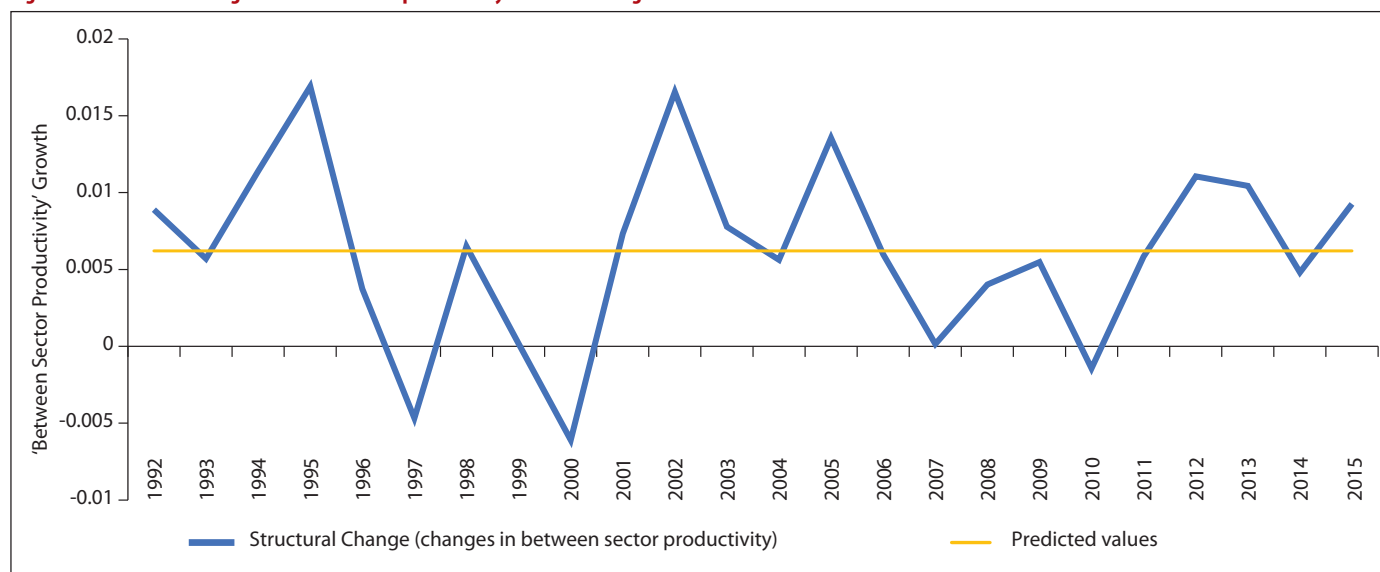
coming years. Depressed global economic growth is likely to continue and the rise of protectionist measures by Group of Twenty countries may have a negative effect on Bangladesh's export trade environment. During this period, the share of agriculture in total labour force is expected to gradually creep downwards, while the share in industry is expected to rise (Figure 3). Moreover, developing countries, which are both sources of raw materials for Bangladesh's industries and destinations for Bangladesh's products, are unlikely to confront sluggish economic growth, which would have consequences for Bangladesh's external trade and FDI inflow. Hence, the future trends of various indicators may be different than projected. However, what is rather discouraging to note is that, share of services sector in the labour force, a key indicator of structural transformation of the economy, does not show a

structural change can be carried out by comparing the country's position and direction with those of emerging economies that are performing better. Projections with regard to structural change suggests that while Bangladesh does not exhibit a decline in 'between sector productivity' growth, the pathway to structural transformation in 2025 will be an almost flat line (Figure 4). Therefore, even with a relatively high level of productivity, the trends for higher structural change seem to be limited.

Structural Transformation-enabled Smooth Transition after Graduation

Structural transformation-enabled smooth transition after graduation indicates how structural transformation and graduation from the LDC group are connected. As observed in the cases of

Figure 4: Linear Forecasting of 'between sector productivity' Growth in Bangladesh



Source: Authors' estimates based on International Labour Organization data.

significant rise. While there is no set level of structural transformation required to achieve smooth transition after graduation, an analysis of Bangladesh's performance in terms of

graduated economies, the transition to graduation is difficult in the absence of structural transformation, especially when economies lose trade preferences and other special and differential treatment

provisions. In order to establish the relationship between structural transformation and graduation from the LDC group, a panel data analysis was carried out to study the effects of selected indicators under the graduation criteria on the structural change term. Adopting the methodology used by McMillan and Rodrik (2011), random-effect regression analyses allow the study of the determinants of structural change. An economy experiencing graduation could maintain a position of strong structural transformation if it fulfills certain conditions. Analysis shows that a) the economies starting with a large share of the labour force employed in the agriculture sector have higher potential for structural change, and b) macroeconomic stability in terms of inflation rate and private investment is significant for structural transformation. In contrast, the graduation criteria have little effect on structural transformation. Given the different levels of importance of the abovementioned issues, the pathway to graduation needs to consider other criteria that directly affect the structural transformation of an economy.

Policies Planned to Encourage Structural Change

For Bangladesh to overcome the challenge of slow structural change, policies targeting the growth of more productive sectors, such as manufacturing and services, need to be implemented. According to its Seventh Five Year Plan (7FYP), Bangladesh's government plans to promote structural transformation by devel-

oping the manufacturing and services sectors (Planning Commission, 2015). Its strategy for the manufacturing sector is to encourage higher investment and direct foreign direct investment towards export-oriented manufacturing. Foreign direct investment not only encourages increases in private investment required to increase productivity but also enables the 'spillover effect', which happens through transfer of better technology and managerial skills from the economies that provide investment.

To sustain long-term structural change, the services sector has to be modernised in terms of both technology and skills. According to the 7FYP, Bangladesh's government is expected to concentrate on three industries including international transport, tourism and information and communications technology services. It plans to implement a deregulation plan for private investment in traditionally public industries such as education, information and communications technology services, aviation and electricity. It encourages investment to upgrade education and training quality, including an emphasis on expanding tertiary education.

As UNCTAD (2016) estimation indicates, Bangladesh's export losses following its LDC graduation, could be to the tune of 5.5 per cent to 7.5 per cent as a consequence of preference erosion. Hence, Bangladesh has to significantly increase both labour productivity and sectoral productivity to maintain and enhance its competitive presence in the global market.

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Authors

Dr Khondaker Golam Moazzem is a Research Director at the Centre for Policy Dialogue (CPD), Dhaka, Bangladesh. He can be reached at: moazzem@cpd.org.bd

Ms Akashlina Arno was a Research Associate at the Centre for Policy Dialogue (CPD), Dhaka, Bangladesh.

Executive Editor: *Anisatul Fatema Yousuf*, Director, Dialogue & Communication, Centre for Policy Dialogue (CPD), Dhaka, Bangladesh.

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